

## **Op-Ed**

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### **Local Innovation for National Prosperity**

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The December 26 earthquake and tsunami have had an enormous impact on Indonesia and the economic program of the Yudhoyono Government. USAID Indonesia and a host of U.S. government agencies have worked closely with the GOI to provide relief and other assistance to the affected areas. Within days of disaster, the USS Abraham Lincoln began delivering life saving medical and humanitarian supplies in a blizzard of helicopter sorties. USAID rapidly mobilized additional relief supplies, including food, water purification kits, medical supplies, generators, trucks and other assistance. To date, the U.S. government has invested more than \$42.1 million in the relief effort, and now has turned to rehabilitation and reconstruction. With an additional \$950 million requested by President Bush for the tsunami response, USAID Indonesia will continue to support the GOI in the rehabilitation of Aceh, a tragedy that has captured international attention and will become an historical marker for many. While USAID assists in addressing the unique post-tsunami reconstruction needs of Aceh, we also remain committed to our fundamental goal of creating growth, jobs and prosperity for all of Indonesia.

Since taking office, the Yudhoyono Government has notched some notable economic successes. Economic growth accelerated in the fourth quarter of 2004, lifting the annual rate to 5.1%. The availability of financing, in particular for SMEs, has grown throughout the last year, and we expect this trend to continue as many banks report strong balance sheets, earnings, and liquidity. Since November, all the major international rating agencies have boosted Indonesia's sovereign rating to the equivalent of B+, a remarkable three-notch leap in less than two years. On February 11<sup>th</sup>, Indonesia came off the list of non-cooperating countries because of its strident efforts to combat financial crime and corruption -- testament to the Government's resolve in fighting financial crime.

A mood of optimism clearly has emerged, and I share this hope for Indonesia. The Government has advanced a sound, sensible and practical economic program. The Government, in its first hundred days, has produced credible results that fuel optimism will stimulate further gains. The perception of Indonesia domestically and in the international marketplace has begun to change, as evidenced by a stock market that has vaulted to 1,100 from 700 when the Government took office, and by the rash of rating upgrades. Further efforts to improve and strengthen the investment and business climates remain essential.

The World Bank estimates that it takes 570 days to enforce a contract, and costs on average 126% of the contract value. Enforcing a bankruptcy takes more than 6 years,

well above the regional average, and yields only 10 cents on the dollar. The international community, including many donors such as USAID, closely watch these barometers of the investment climate.

Improving these and other criteria of investment attractiveness comprise goals for USAID, and we find it reassuring that the government has pledged ongoing support for reforms that directly affect business. This means reforms that drive the micro-economy, which translate directly to growth, jobs, and income.

It falls upon the national government to create conditions conducive for business growth but local government has a critical role to play, as well. Last week, Regional Autonomy Watch (KPPOD) recognized those Kota and Kabupaten that lead in promoting local economic growth in Indonesia. These local governments have distinguished themselves by creating a climate conducive to business that will build stronger local economies and, therefore, a more stable national economy. They have created an environment that invites business, and creates jobs that lead to prosperity. They have demonstrated that they can implement economic policies and strategies to fuel growth and local competitiveness.

President Yudhoyono has advanced a strategy that builds from the bottom up, making local economies the engines of national economic growth; we embrace and support his strategy.

One first step in the reform process consists of getting businesses to register. Registered businesses have access to credit and, therefore, can grow more quickly. Registered businesses also tend to implement better labor practices, and, pay their taxes, and contribute to a stronger and more stable Indonesia. Yet, the World Bank reports that registering a business in Indonesia remains complicated, lengthy, and expensive. With USAID support, however, more than a dozen local governments have reduced substantially the time for businesses to register. Through The Asia Foundation, 15 one-stop-shops now register businesses more efficiently, and less expensively, and with powerful results:

- The time to register a company has fallen by 60%, and on average now takes 15 days.
- Cost has dropped an average of 30%
- Nearly 70% of the firms reported higher profits and higher employment, three quarters reported paying higher salaries after they registered.
- The one-stop shops produce growth, jobs and prosperity.

In addition to removing obstacles to business at the local and national levels, the Government also has worked to remove “behind the border” obstacles to economic growth, trade and commerce. In a February 14 Jakarta Post article, Minister Pangestu drove this point home. Economic obstacles such as nuisance taxes and levies, unfortunately, have increased since 2001. To ship East Java apples to the capital has become more expensive than to ship apples from New Zealand, because many kabupaten

along the road from Malang to Jakarta levy a fee or tax. Nuisance fees and taxes strangle domestic trade and threaten to make Indonesian exports less competitive.

Consistent with Minister Pangestu's initiative to remove "behind the border" obstacles, USAID will assist in removing unnecessary regulation and nuisance taxes. This will reduce friction that prevents efficient markets from functioning and will encourage business to grow. Implementing a Domestic Trade Law would help contain these market-distorting practices. This Law could include provisions similar to those in the U.S. Interstate Commerce Act, which facilitates trade and commerce among the fifty States. Establishing the equivalent of an Interstate Commerce Commission to oversee and regulate domestic trade in goods and services could prove worthwhile, as long as it did not become just another bureaucratic hurdle to trade.

The regions hold the future of Indonesia's democratic and economic transformation, therefore, USAID provides substantial assistance to local governments. That assistance includes working with local government to establish participatory planning, performance-based budgeting, and to improve management and delivery of basic services: education, water, sanitation, health and nutrition. We see as imperative that local governments establish transparent -- i.e., open to public scrutiny and input -- management systems-- and that provide quality public services to business and the community. All governance programs have one common objective: to help local governments improve the quality of life for Indonesia's citizens.

Over the past years, USAID has helped about 150 local governments in 14 provinces strengthen and deepen local community involvement in local planning, budgeting and governance. As a result, many local governments have better performance plans, stronger communities and economic development, and have begun more efficient delivery of basic services. USAID will continue to work with local government throughout Indonesia to advance reforms.

Stronger more capable local governance, and market-oriented national and local-level economic policies remain key to attracting investment to regions that can drive national growth. Having a skilled and well-educated labor force, however, will prove a critical determinant of investment potential and attractiveness. Over the past four decades, all of the countries that have built economic growth through substantial inflows of foreign direct and domestic investment, have succeeded because they themselves invested heavily in their youth and in their people.

USAID will devote \$157 million to education in Indonesia over the next five years. We will focus on primary education -- the source of Indonesia's next generation of leaders and entrepreneurs. With the Government's expressed promise to dedicate a portion of the savings resulting from the reduction of energy subsidies to education, we see education reform as very possible. Broadly available quality primary education will yield long-term dividends that will propel the Indonesian economy forward.

The President, the Vice President, and the cabinet have expressed firm commitment to making Indonesia more competitive, more prosperous, and a better place to live and do business. Helping Indonesia compete and build local government capacity to establish an environment where business can grow and create jobs has a high priority for USAID. USAID will continue its tradition of supporting the people of Indonesia in achieving these vital goals. USAID remains a partner that Indonesia can count on.